NO. 2912

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United States
Circuit Court of Appeals
For the Ninth Circuit

THE FIRST NATIONAL BANK OF SAN FRANCISCO et al.,

Appellants,

vs.

DETROIT TRUST COMPANY et al.,

Appellees.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION.

BRIEF OF APPELLEES

Snow, McCamant & Bronaugh,
Bridges & Bruener,
Solicitors for Appellees.

Northwestern Bank Building, Portland, Oregon.
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STATEMENT OF THE FACTS.

S. E. Slade Lumber Company is the owner of a valuable tract of timbered lands situated in Township 21, North of Range 9, West of the Willamette Meridian, in Grays Harbor County, Washington, and of a valuable sawmill plant situated in the City of Aberdeen. It mortgaged all this property to Detroit Trust Company and Alexander McPherson,

as Trustees, to secure an indebtedness of One Million Dollars of which there remains due the principal sum of $550,000 (R. 31). Later Slade Lumber Company gave its second mortgage to Detroit Trust Company to secure an indebtedness of approximately the sum of $69,000. On the 30th day of April, 1915, a certain creditors agreement was entered into by and between The American National Bank of San Francisco, Welch & Company, United States National Bank of Portland, Slade-Wells Logging Company, Humptulips Logging Company, First National Bank of San Francisco, Coats-Fordney Logging Company, Saginaw Timber Company and Sudden Estate Company, which agreement was entered into for the purpose of protecting and securing the claims of the unsecured creditors of S. E. Slade Lumber Company, and with the purpose of committing the signers of said agreement to the advancement, for a period of one year and optionally for two years, of sufficient moneys to pay the interest on the bonds secured under the first mortgage, as well as the interest on the second mortgage; the taxes on the property and the insurance premiums, upon condition that the first mortgagee would waive the collection for a period of one year, and provisionally for a period of two years, of the principal of the maturing bonds under said first mortgage. Under said creditors agreement it was contemplated that a third mortgage should be made by S. E. Slade Lumber Company to First Federal Trust Company, a corporation, as Trustee, covering the properties of the

Lumber Company described in the first and second mortgages, including other property (R. 160). The third mortgage was thereafter duly executed (R. 168). The creditors agreement provides that the parties thereto shall be represented by a committee consisting of Geo. A. Kennedy, representing The First National Bank of San Francisco; P. E. Bowles, representing The American National Bank of San Francisco and A. P. Welch, representing Welch & Company, and it is provided in said agreement that said committee, representing all the creditors, should have power only to act unanimously and not by a majority. The third mortgage provides, among other things, that the Trustees shall be under no obligation or duty to perform any act thereunder, unless requested in writing so to do by duly appointed representatives of said The First National Bank of San Francisco, The American National National Bank of San Francisco and Welch & Company (R. 196), and it is further provided therein that the Trustees shall have the exclusive right of action thereunder and that none of the beneficiaries should be entitled to commence any action unless the Trustees should refuse or fail so to do when properly thereunto requested (R. 197).

Detroit Trust Company and Alexander McPherson, as Trustees, duly filed their bill of complaint, seeking to foreclose the first mortgage. Thereafter they filed a petition praying for the appointment of a receiver with power to operate (R. 90). Attached to the petition for the appointment of a receiver is

the assent of S. E. Slade Lumber Co., Humptulips Logging Co. and Slade-Wells Logging Co., with a prayer that the court make the order applied for (R. 100, 254). At the time of the appointment of the Receiver, P. E. Bowles and A. P. Welch, two of the three members of the committee named in the creditors agreement hereinabove mentioned, by telegram to the clerk of the court requested the appointment of a receiver as prayed for in the petition (R. 152). At the same time American National Bank of San Francisco and Welch & Company, two of the beneficiaries under the third mortgage, by telegram to the court requested the appointment of a receiver as prayed for (R. 254). Attached to the petition for the appointment of a receiver, among other affidavits, was also the affidavit of John C. Ainsworth, President of the United States National Bank of Portland, one of the beneficiaries under the third mortgage.

After the appointment of a receiver and after the receiver had, with the approval of the court, entered into a logging contract with Humptulips Logging Company, the appellants herein appeared by petition and moved the vacation of the order appointing the receiver with power to operate, upon many grounds. It is also alleged in said petition that the Trustees under the third mortgage are under the terms of the mortgage under no obligation to perform any duty thereunder unless requested so to do in writing by the duly appointed representatives of The First National Bank of San Francisco,

The American National Bank of San Francisco and Welch & Company respectively, and have not appeared in or taken any action in the premises; that the said American National Bank of San Francisco and Welch & Company, by their respective representatives, have joined in a request for the appointment of a receiver with power to operate and refused to join with petitioners to request the Trustees to act in the premises herein (R. 118, 119).

The Trustees under the third mortgage, First Federal Trust Company and Milton R. Clark, have made no appearance in this suit. As appears by the court's order made **sua sponte** (R. 295, 296), said Trustees brought an independent suit against all the beneficiaries under the third mortgage, for instructions with reference to their powers and duties under said third mortgage, and after hearing the court rendered a decree in said suit to the effect that in the absence of unanimous instructions from the said Geo. A. Kennedy, P. E. Bowles and A. P. Welch, the committee representing the creditors, the Trustees were under no duty or obligation to appear in this suit (R. 300). The court in its order **sua sponte** authorized all of the beneficiaries under the third mortgage to appear in this suit and take such action as they might deem proper (R. 302).

Thereafter American National Bank of San Francisco, Welch & Company, United States National Bank of Portland, Slade-Wells Logging Company, and Humptulips Logging Company, being the majority both in number and amount of

the beneficiaries under the third mortgage, (the smaller creditors having been paid off R. 287, 298), filed an answer challenging the right of the appellants, by reason of the terms of the creditors agreement and the third mortgage, to appear and contest the appointment of a receiver with power to operate, and further submitting that if the beneficiaries under the third mortgage are proper parties defendant, then that the order of the court appointing a receiver with power to operate and the order of the court authorizing the receiver to make and enter into a logging contract with Humptulips Logging Company and approving said logging contract, be continued in force for the reasons which are stated at length in said answer (R. 130).

There was considerable testimony offered by the plaintiffs and the Receiver in support of the petition for the appointment of a receiver and the logging contract entered into with Humptulips Logging Company.

The testimony in brief is as follows: Prior to the 2nd day of June, 1915, and ever since that date, the Slade Lumber Co., with the knowledge and consent of the creditors secured under the third mortgage, attempted to sell its timber holdings for $1,250,000., which price is substantially on the basis of $2.35 per M feet, board measure, for all of the timber on said lands, but without success (R. 261, 262, 275). The timber market is characterized by a very general desire on the part of owners to sell and little inclination on the part of capital to buy, and large

tracts of timber can now be bought at prices substantially identical with those paid in 1906 and 1907. There is much timber that may be acquired by undertaking to pay for it as it is cut. The competition of today in the timber market is between sellers rather than buyers, and the value of the Slade tract cannot be secured for the owners under present conditions, except by cutting and marketing the same (R. 256, 257, 258, 260, 262, 268, 270, 271, 273, 276). The Slade Lumber Co. is unable at the present time to pay its debts as they mature and if the properties of the Lumber Company are forced to sale, they would not bring enough to pay the debts of the Company (R. 255, 257). It is absolutely necessary for the preservation of the property, and to prevent the waste and deterioration of the same, that a receiver be appointed to conduct such operations as will enable the Lumber Company to have its timber lands logged and the proceeds applied to the payment of taxes, insurance premiums and other incidental charges and to the extinguishment of the debts of the Company. In no other way than by a logging operation conducted on the timber lands of the Company, can the Lumber Company ever raise sufficient moneys to pay the debts due from it to its creditors, and if such operations are not commenced and conducted immediately, the property of the Company will so deteriorate in value as to be insufficient to pay the debts due from the Company (R. 255, 256). The appointment of a receiver as prayed for is the most advantageous plan to adequately conserve the

properties of the Lumber Company, protect its creditors and save an equity for the Lumber Company (R. 255, 257).

The valuable mill property of the Company is, because of insufficient care and attention, due to lack of funds, daily deteriorating in value and being wasted, and unless something is done immediately for the preservation and upkeep of the mill property it will soon lose the greater part of its value (R. 257, 259, 260).

In the year 1912 the Warren Company was engaged in logging the timber lands of the Slade Lumber Co., but defaulted in its contract. By reason thereof the logging operations of the Warren Company were not cleaned up in a proper manner and there is constantly a very decided danger of great loss to the timber by forest fires; that if such a fire ever started in the mortgaged property it would cause irreparable injury and damage thereto because of the condition of the logged over places in the property and because no fire patrol is kept. The danger of fire to the mortgaged property is increased by the fact that in the immediate neighborhood thereof there is a large quantity of logged-off lands and because of the fact that several logging operations are now being and have lately been conducted in the immediate neighborhood of the mortgaged property (R. 259). There have been a number of fires in the vicinity of the Slade lands and as late as the year 1915 there was a fire in Section 23, which would have destroyed all the felled timber of the Slade Lumber

Company had it not been for the fact that a logging crew happened to be in that vicinity and were able to put out the fire (R. 279, 280). It is entirely possible to greatly minimize any danger by fire by the employment on the property of a force of men engaged in logging the same (R. 259).

At the time the Warren Company ceased operations there were and there now are in the neighborhood of twelve million feet of Fir logs which have been cut and bucked and which now lie in the woods and have not been moved on account of the financial inability of the Lumber Company to move them. These logs represent where they lie approximately $70,000. These logs are daily deteriorating in value and will soon be of no value unless they can be removed from the woods and sold. Said logs also constitute an extraordinary fire risk. The skidroads which have been constructed upon the property and the moneys which have heretofore been spent in opening up the property so that it could be properly logged, will be entirely lost unless steps are immediately taken to conduct logging operations upon said lands (R. 260).

The only testimony attacking the contract which the Receiver made with the Humptulips Logging Co., is the affidavit of A. J. Morley, the Manager of Saginaw Timber Company, one of the appellants. Against this affidavit we have the affidavit of S. E. Slade, President of S. E. Slade Lumber Company, (R. 261), the affidavit of C. M. Weatherwax, President and Manager of Aberdeen Lumber & Shingle Com-

pany, (R. 266), the affidavit of A. L. Paine, the Manager of National Lumber & Manufacturing Company, (R. 269), the affidavit of William Corkey (R. 269), O. P. Burrows (R. 271), Eugene France (R. 272), W. J. Patterson (R. 273), W. B. Mack (R. 274), and Almerion P. Stockwell (R. 278). These affidavits are from men who are intimately acquainted with timber values, logging contracts, logging operations and the market price of logs on Grays Harbor. They say that the Slade timber cannot be sold in the open market on the basis of $3. per M feet stumpage and only by a logging contract can any such value be realized; that any logging contract which returns to the Slade Lumber Co. stumpage at the rate of $3. per M feet for all timber removed, would insure to the owner the full market value of the timber (R. 262, 267, 269, 270, 271, 272, 273, 275, 278). That they have examined the contract in question and that said logging contract is a very fair and profitable contract for the Receiver and for the estate of the S. E. Slade Lumber Co., and the only means by or under which all of the creditors of the Lumber Company can be paid and any possible equity in the lands saved for the Lumber Company (R. 262, 264, 267, 269, 270, 272, 273, 276, 279). Said contract does not permit any undue and unreasonable profits and gains to the Humptulips Logging Co., and considering the obligation of the Logging Company to finance the logging operations, the depreciation on its equipment, the interest on its investment, its logging expense and other charges

not included in logging expense under the contract, the fluctating market value of logs on Grays Harbor and the risks which the Logging Company must take under said contract, the compensation up to $1. per M feet to be paid to the Logging Company, provided the logs sell for sufficient to pay said $1. or any part thereof, is a very reasonable compensation to be paid to the Logging Company. Under the terms of the contract, if any profit over and above $1. is realized, said profit must be paid to the Receiver, and such provision is more favorable to the Receiver and to the owner of the timber lands than the ordinary and usual contracts of like nature entered into in the past by loggers in Grays Harbor County. In all contracts between an owner of timber and a logger, for the logging of timber, the logger always figures on making the sum of $1. per M feet over and above all expenses and after paying the stumpage value to the owner as agreed upon, and such $1. per M feet is the customary and usual profit which a logger expects to make. Said contract ample protects the Receiver, the defendant S. E. Slade Lumber Co. and the creditors of said Lumber Company, and does not permit the Humptulips Logging Co. or anyone else to over-reach the Receiver or the beneficiaries of the estate (R. 265, 268, 269, 270, 271, 274, 276, 277, 279.)

In addition to the foregoing affidavits we have the testimony of John C. Ainsworth, President of United States National Bank of Portland, (R. 263),

D. B. Fuller, Vice President of American National Bank of San Francisco (R. 265), A. P. Welch, President of Welch & Company (R. 266), C. B. Wells, President of Slade-Wells Logging Company (R. 266), which corporations, together with Humptulips Logging Company, represent a majority, both in number and amount, of the claims secured under the third mortgage. These affidavits set forth that it will be for the best interests of all the creditors of the Lumber Company, and more particularly for the interests of all the creditors secured by the third mortgage, that the timber lands of the Lumber Company be cut and logged; that they are acquainted with the logging contract which has been entered into by the Receiver and in their opinion said contract is a fair and reasonable contract and that it will be to the best interests of all the creditors that the contract be kept in force and carried out.

It is further shown by the affidavits of John C. Ainsworth (R. 264), C. M. Weatherwax (R. 268), W. J. Patterson, Cashier and Manager of Hayes & Hayes Bank, (R. 274), and A. L. Paine (R. 269), that if the logging operations are conducted under said contract for a period of two or three years, the indebtedness of the S. E. Slade Lumber Co. will be so materially reduced and the advantages of said timber lands and the operations thereunder as a going concern be made so apparent that it will be possible for the Lumber Company either to re-finance its obligations or make possible the sale of its properties at a price more than adequate to pay the in-

debtedness of the Lumber Company and leave an equity for it.

The timber, if logged under the contract in question, will be brought to market by means of the Humptulips River, which now is and for upward of twenty years past has been one of the most extensive and successful logging and driving stream in Grays Harbor County (R. 275, 267, 269). The Grays Harbor Boom Company and Humptulips Driving Company are public service corporations operating on the Humptulips River, and the customary and public charge of said Companies and of Humptulips Towing Company, for timber, taking the rate as the Slade timber, is $1.25 per M feet (R. 280).

It is further shown that the financial condition of Humptulips Logging Co. is sound and that the Company is amply able to carry out the terms and conditions of its contract (R. 274).

Prior to the commencement of the foreclosure suit and, to-wit, in the early part of the year 1915, H. P. Brown, President of Humptulips Logging Co., made a proposition for the logging of the Slade timber, to the committee of creditors. This proposition is shown on page 289 of the Record. The answer of the committee of creditors, the First National Bank of San Francisco being represented by James K. Lynch, its Vice President, is shown on page 290 of the Record. The proposition submitted by Mr. Brown was to log the timber at cost, plus $1. for operation, which was acceptable to the representative of the First National Bank (R.287).

It is further shown that the total indebtedness of the Lumber Company is about $1,200,000.00 (R. 289). Creditors whose claims aggregate five-sixths of this total ask for the continuance of the Receivership (R. 261).

RECEIVERSHIP DISCRETIONARY.

No proposition is better settled than that the court of original jurisdiction enjoys a wide discretion in the appointment of a receiver. The principle is thus stated in

High on Receivers, 4th Ed., Sec. 7.

> "The appointment of a receiver pendente lite, like the granting of an interlocutory injunction, is to a considerable extent a matter resting in the discretion of the court to which the application is made, to be governed by a consideration of the entire circumstances of the case. And since the appointment of a receiver is thus a discretionary measure, the action of the lower court in appointing or denying a receiver pendente lite will not be disturbed upon appeal unless there has been a clear abuse."

Also same work, Section 25:

> "It may be safely said that, since the appointing or refusing a receiver is largely a matter of sound judicial discretion, even in those states where an appeal is allowed from such interlocutory order, if the testimony addressed to the court below is conflicting, and if that court, after duly weighing and considering the testimony, either appoints or refuses to appoint a receiver, an appellate court will not interfere with the exercise of this discretion, in the absence of any facts showing that it has been

abused. And when the testimony is conflicting and the court below has, after hearing, refused to revoke its appointment of a receiver, an appellate court will refuse to control the discretion of the inferior tribunal."

This principle is recognized by a well considered decision of this court.

> Heinze vs. Butte & Boston Co., 126 Fed. 1, 11.

In this case Judge Gilbert said:

> "An appellate court will not reverse the order of a lower court in appointing a receiver or in directing his action, unless it appears that the discretionary power of the court has been so improvidently and improperly exercised as to bring its action clearly within the meaning of the term 'abuse of power'.' Beach on Receivers, Sec. 118; Sanders vs. Slaughter, 89 Ga. 34, 14 S. E. 903; Nimocks vs. Shingle Co. 110 N. C. 230, 14, S. E. 684; Beaumont vs. Beaumont, 166 Pa. 615, 31 Atl. 336; Fluker vs. City Railway Co., 48 Kan. 580, 30 Pac. 20. In the case last cited the court said:
>
> > " 'Unless a very strong showing is made, or this court is satisfied that the discretionary power has not been properly exercised, the conclusion below will not be disturbed.' "

While the question of procedure is one which is to be determined in the light of the federal precedent, it is worth while to call the attention of the court to the fact that the rule as announced by the Washington Supreme Court is in substantial accord with the foregoing authorities.

> Cameron vs. Groveland Improvement Co., 20 Wash. 169, 170.

In this case Mr. Justice Reavis said:

"The superior court appointed a receiver pending the trial of the cause.

"The rule which this court observes in reviewing an order of the superior court appointing a receiver has been stated in Roberts vs. Washington National Bank, 9 Wash. 12 (37 Pac. 26) :

> 'The making of such orders is committed, under our system, to the sound discretion of the judge before whom the proceeding is pending, and his decision of the question must stand, unless the appellate court, upon an examination of the law and facts of the case, shall affirmatively determine that his action was not warranted; and in determining this question, the decision of the questions of fact will not be reversed if there is a substantial conflict in the proofs in regard thereto. But the appellate court must examine such proofs for the purpose of determining whether or not there is such a clear preponderance against the determination of the lower court'."

For other authorities to the same effect see

4 Pomeroy's Equity Jurisprudence, 3d Ed., Sec. 1331.

Corning vs. Siesel, 101 Ga. 389; 28 S. E. 861.

POSITION OF APPELLANTS.

It is only because of the discretionary character of the relief that these appellants had any right to a hearing in the court below. They were not parties to the foreclosure bill, they were merely a minority, both in number and amount, of the creditors of the S. E. Slade Lumber Company, whose claims were

secured by a third mortgage on its properties. The third mortgage is a part of the record and by its express terms it vests the trustees under the mortgage with the exclusive right of action thereunder. This is plainly the effect of the following language taken from the mortgage:

> "The parties of the second part shall have the exclusive right of action hereunder, and no party hereby secured shall be entitled to commence any action to enforce these presents, unless the parties of the second part shall refuse or fail so to do when properly thereunto requested." (Record 197.)

The mortgage itself is collateral to a creditors' agreement, under which these appellants have virtually turned over the control of their claims to a committee of creditors consisting of George A. Kennedy, P. E. Bowles and A. P. Welch. This creditors' agreement is also a part of the record. The agreement contains the following language :

> "The said George A. Kennedy, P. E. Bowles and A. P. Welch, their successor or successors, shall have power only to act unanimously and not by a majority." (Record 166, 167.)

Mr. P. E. Bowles and Mr. A. P. Welch, two of the three making up the creditors' committee, have joined with plaintiffs in the case at bar in requesting the court to grant the receivership. Mr. George A. Kennedy, one of the three trustees under the agreement, is in sympathy with the position of appellants. Appellees did not raise this question in the

court below, being of the opinion that the court, in passing upon an original application for the appointment of a receiver, should listen to any representations made by anyone in anywise interested in the property. It by no means follows that these appellants are to be deemed parties to the suit in such sense that they have a right to review on appeal the action taken by the lower court. Certainly this court should not set aside the receivership order passed by Judge Cushman at the instance of parties situated as these appellants are, in the absence of an overwhelming showing as to the folly of the order and the injustice done thereby.

UNCONTROVERTED FACTS.

The record in this case is in such condition that appellees are entitled to claim that they have prevailed on all of the controverted questions of fact, but the uncontroverted and indisputable facts are sufficient to justify the receivership order from which this appeal is taken. These facts must certainly be deemed to be established by the record.

1. If the property of the S. E. Slade Lumber Company is sold at forced sale its value cannot be secured, and the proceeds of the sale in the absence of a bid made by one or more of the mortgagees, will probably be inadequate to the payment even of the first mortgage.

2. The timber lands of the S. E. Slade Lumber Company, if their value shall be conserved and realized, are much more than sufficient to pay the first

and second mortgages, and are probably sufficient to pay the third mortgage as well. The Aberdeen properties of the said defendant are worth a large sum of money, in all probability a sum sufficient to take care of any possible deficiency remaining due to the creditors under the third mortgage after the disposition of the timber land, if the value of the timber is conserved and realized.

3. The Slade Lumber Company is wholly without available resources. It is wholly unable to pay taxes upon its properties, or to meet the other expenses incident to their care and protection.

4. In the absence of some arrangement under which the taxes on the property can be paid the property will be sold for delinquent taxes, and lost to all of the parties to this suit.

5. The mill property, while intrinsically valuable, imperatively demands care. In the absence of proper care and protection by insurance and otherwise there are many chances that this asset will be lost by fire. The Washington statute, 1 Remington & Ballinger's Code, Section 741, provides in part as follows :

> "A receiver may be appointed by the court in the following cases :
>
> "4. In an action by a mortgagee for the foreclosure of a mortgage and the sale of the mortgaged property, when it appears that such property is in danger of being lost, removed, or materially injured."

6. Under the contract which the receiver has made, pursuant to authority given by the court, the timber will net the estate at least $3.00 per thousand feet. Under the Lacey cruise this means that the estate will receive upwards of $1,500,000.00 from the logging operations alone. This sum is much more than sufficient to pay all three mortgages.

7. The receivership is requested by the owner of the equity of redemption, the first mortgagee, the second mortgagee, and by a majority, both in number and amount, of the creditors secured under the third mortgage.

8. The contract under which the receiver is logging the lands involves no risk of receivership indebtedness paramount to the liens now subsisting on the property.

9. The contract with Humptulips Logging Company assures to the creditors of the S. E. Slade Lumber Company the full market value of the property.

It would be difficult to find a case in the books under which it has been held that a receivership is improperly granted under such a showing as that above recited. The Washington statute quoted above is declaratory of a principle of equity jurisprudence which is well established. Where, for any reason, the mortgagor is unable to take care of the property, a receiver is properly appointed at the instance of the mortgagee to prevent waste.

Farmers' Co. vs. Meridian Co., 139 Fed. 661, 664.

It is true that under the laws of Oregon and Washington the courts will not appoint receivers in foreclosure suits simply because the mortgage so stipulates. This has been determined by the Federal Supreme Court in

Teal vs. Walker, 111 U. S. 242, 251,

and by this court in

Couper vs. Shirley, 75 Fed. 168.

The opinion in the latter case begins by calling attention to the fact that the receivership in that case was claimed solely on the ground of the stipulation contained in the mortgage, and the decision is merely to the effect that such a stipulation will not be honored as of course by the courts. The decision does not modify the well settled principles of equity jurisprudence on which we rely in the case at bar. The principle of the two Federal decisions above referred to is recognized by the Supreme Court of the State of Washington, and it is nevertheless held by that court that in a foreclosure suit a receiver will be appointed whenever such action is necessary to prevent waste.

Collins vs. Gross, 51 Wash. 516.

A court of equity is always concerned for the conservation of assets over which it has acquired jurisdiction. When necessary to such conservation the court will appoint a receiver and will authorize him to conduct the business.

Cake vs. Mohun, 164 U. S. 311, 315 to 316.

This court upheld the appointment of a receiver, who was authorized to operate a cannery, where the order of the lower court was based upon a proper showing to the effect that the operation of the cannery was essential to preserve the asset over which the court had acquired jurisdiction.

Pacific Northwest Co. vs. Allen, 109 Fed. 515.

In response to the suggestion made by appellants, that this court will never appoint a receiver to operate a business which is not a going concern at the time when the receiver is appointed, we cite

Elk Fork Co. vs. Foster, 99 Fed. 495, 497.

In this case a receiver was authorized and directed by the court to continue the work of prospecting and exploration on the defendant's properties for the purpose of discovering oil and gas thereon, and was authorized to operate any oil wells which were the result of his exploitation. This order was approved by the Circuit Court of Appeals for the Fourth Circuit. On this branch of the case appellants rely on

High on Receivers, Sec. 36.

The text is based wholly on the case of

Merrill vs. Pemberton, 62 Ga. 29.

This was a case in which the lower court was asked to appoint a receiver who should take over

certain formulae or prescriptions for the manufacture of patent medicine. The court was asked to authorize the incurring of indebtedness to start a manufacturing plant to engage in the patent medicine business. The formulae were secret and a part of the relief requested was that the defendant should be required to disclose the formulae to the receiver. Such a receivership, and such a form of relief were properly denied.

If it be said that the receivership granted in the case at bar will continue for an unreasonable length of time, we answer that the contract entered into between the receiver and the Humptulips Logging Company is subject to cancellation on sixty days' notice (Record 114). The presumption is that the lower court will direct a cancellation when the interests of the estate so demand. In this connection we call attention to the affidavits of John C. Ainsworth (Record 264) and W. J. Patterson (Record 274) and C. M. Weatherwax (Record 266) to the effect that in their opinion it will be possible to refinance the indebtedness of the S. E. Slade Lumber Company approximately within two years, if the operations of the receivership shall make such a showing as these witnesses anticipate. Issue has not been joined on the allegations of these affidavits, and they are, therefore, entitled in this court to full faith and credit. In view of the fact that these appellants are not entitled to a foreclosure of the third mortgage, because of the conditions of the mortgage and of the creditors' agreement collateral thereto,

it certainly cannot be held that the lower court is doing them an injustice in permitting the logging of the property for a period not exceeding two years under conditions which assure that the full market value of the timber will be secured and applied to the liquidation of lien indebtedness admittedly prior to that of these appellants.

The paramount objection to the operation of a business under a receivership is the possibility of creating new lien indebtedness to which the other indebtedness of the defendant must be postponed. In the case at bar that danger is guarded against. The Humptulips Logging Company is financially responsible. This appears from the showing made in support of the receivership, and is in nowise controverted. Under the contract with the Humptulips Logging Company there is assurance that the creditors will receive $3.00 per thousand feet for all logs cut on the mortgaged lands. It is hoped that the payments may exceed this amount, but the showing is that this amount represents the full market value of the timber, and the contract is drawn in such a way as to absolutely assure the payment of this amount in reduction of the lien indebtedness. Subsequent encumbrancers receive all the relief to which they are entitled if they are assured that the assets of the debtor will be applied in reduction of a prior lien.

United States vs. Masich, 44 Fed. 10.

It is contended that a receivership will in no case be granted in a foreclosure suit unless there is

a showing as to the inadequacy of the security. The cases relied upon on this branch of the case will all be found to be cases in which the owner of the equity of redemption resists the appointment of a receiver. The authorities relied on by appellants are not in point because of the fact that the mortgagor, the first and second mortgagees, and a majority, both in number and amount, of the beneficiaries of the third mortgage, join in the request that this receivership be continued. The case of

Warner vs. Gouverneur, 1 Barb. 36,

is a case in which the mortgagor and his successors in interest were strenuously resisting the receivership. The case is therefore distinguishable from the case at bar.

RIGHTS OF FIRST MORTGAGEES PARAMOUNT.

The authorities clearly recognize that the rights of the first mortgagee are paramount. Where a receiver has been appointed in a suit brought by the second mortgagee for the foreclosure of his mortgage, such receiver will be displaced and a receiver appointed at the instance of the first mortgagee when he brings his suit to foreclose.

Schneider vs. Miller, 155 Wis. 239; 144 N. W. 286.

The receivership was granted in the first instance by the court without objection from any source. These appellants then came into court pray-

ing for a modification of the receivership order, and subsequently for a quashing of the receivership order. At the time when these applications were made to the lower court the property was in the possession of a receiver appointed at the instance of the first and second mortgagees, with the consent of the mortgagor and with the approval of a majority in interest of the beneficiaries under the third mortgage. The case therefore is closely analogous to that of a mortgagee in possession. It is well settled that a court of equity will not disturb the possession of such a mortgagee so long as his debt is unpaid.

High on Receivers, 4th Ed., Sec. 679.

United States vs. Masich, 44 Fed. 10.

Trenton Co. vs. Woodruff, 3 N. J. Eq. 210, 212.

It is well settled that a subsequent mortgagee may, through the aid of a court of equity, redeem from the first mortgage where the first mortgagee is endeavoring to enforce his lien.

Frost vs. Yonkers Bank, 70 N. Y. 553.

Ellsworth vs. Lockwood, 42 N. Y. 89, 96.

2 Jones on Mortgages, 1064.

2 Story's Equity Jurisprudence, 1023.

It is possible that these appellants, because of the conditions contained in the third mortgage, and the creditors' agreement appurtenant thereto, would be denied the right of such redemption, but the first and second mortgagees, who are parties to this ap-

peal, hereby expressly stipulate of record that they will consent that such redemption shall take place, if these appellants shall elect to take over their liens, together with the costs and expenses of the litigation up to date. We submit that the remedy of these objecting creditors is to redeem from the two first mortgages, and thus control the foreclosure proceedings. After such redemption they would undoubtedly be in the position to ask the court to discharge the receiver, but in the absence of such redemption the paramount care of the court should be to protect the rights of the first and second mortgagees.

Trenton Company vs. Woodruff, 3 N. J. Eq. 210, 212.

In this case the court said :

"The most important question, is that which relates to the appointment of a receiver of the property covered by the bank's second mortgage, and which is also embraced in the mortgage set up by the trustee. If the trustee is to be considered as a first mortgagee in possession, the case is plain. There can be no receiver as against him. He is entitled to the possession, having the first or legal mortgage, and can only be required to apply the rents and profits to the payment of the debt. The second mortgagee has no remedy, except to redeem. And the rule is so firmly settled, that in Quarrel vs. Beckford, 13 Vesey, 378, Lord Eldon said, that if Beckford the first mortgagee, would swear there was any sum due him, and his mortgage was not satisfied he would not take away the possession from him. And in Barney vs. Sewell, the same learned chancellor says, 'I know of no case where the

> court has appointed a receiver against a mortgagee in possession, unless the parties making the application will pay him off, and pay him off according to his demand, as he states it himself. I cannot appoint a receiver against these defendants, unless you can bring me their confession that they are paid off, or their refusal to accept what is due to them:' 1 Jac. and Walk. 627."

RELATIVE EQUITIES.

We have found great difficulty in finding authorities parallel with the case at bar. The large majority of cases are cases in which the owners of the equity of redemption resisted the receivership. The strength of the position of the appellees in this case consists largely in the fact that the mortgagor not only consented to the receivership but earnestly desires the court to uphold it. A case somewhat in point is

> Philadelphia Co. vs. Oyler, 61 Neb. 702; 85 N. W. 899.

This was a foreclosure suit; a receiver was appointed on the application of the mortgagor and one of his grantees who had assumed the payment of the mortgage debt. The first mortgagee joined in the prayer for a receiver. The receivership was resisted by a second mortgagee to whom the lease on the premises had been assigned. There was a showing of waste in that the owner of the equity of redemption was unable to pay the taxes. The court held that the receivership was proper.

The following from the opinion is in point as to the relative equities of the parties :

"As between the subsequent mortgagee and persons liable personally for a deficiency, the equities are in favor of the latter, who should be relieved of liability before the property or the income therefrom should be taken to satisfy the debt due under the subsequent mortgage. The statute does does not restrict the application for a receiver to a plaintiff, nor is it believed such was intended by the legislative enactment. A defendant may, in a proper case, be heard to make such an application. A receiver will be appointed when justice and equity will thereby be promoted (Beach, Rec. 12). * * * * * * * It would be, it seems to us, permissible for a mortgagor of premises afterwards conveyed to a third party, and which secured a debt upon which he was personally liable, in an action to foreclose such mortgage, and where waste or inadequacy of security is made the basis, to apply for a receiver of such premises for the purpose of having the debts satisfied out of the property pledged to their payment according to priorities, regardless of the question of his solvency and liability to meet a deficiency by reason of his personal liability, and in this case we hold that the mortgagor and grantee had such a substantial and beneficial interest in the suit by reason of their personal liability for the debt as would give them a standing in a court of equity for the purpose of applying for a receiver to take charge of and preserve the mortgaged property, and apply the income to the payment of taxes or in satisfaction of the mortgage debt, and thus lessen their liability, and save them from injury by reason of a judgment for deficiency."

Tysen vs. Wabash Railway Company, 24 F. C. 479.

This was a decision passed by Mr. Justice Harlan, sitting in the Circuit Court for the Southern District of Illinois. The case grew out of a dispute between the bondholders of the Wabash Ry. Co. A large majority of the bondholders had worked out a funding scheme which was considered by them to be the best arrangement for all concerned. The minority of the bondholders were given an opportunity to co-operate and be protected by this scheme; they refused to do so and brought a suit to foreclose the mortgage. In this suit they applied for a receiver. Mr. Justice Harlan said :

> "Upon examination of these and other authorities cited, it will be found that the action of the court has depended largely upon the peculiar circumstances of each case. In no instance has the action of the court, in appointing or refusing to appoint a receiver, rested exclusively upon the technical, legal rights of the parties.
>
> "The rule deducible from the cases, and which commends itself to my judgment as sound, especially in suits to foreclose railroad mortgages, is well stated in the case of Vose vs. Reed (Case No. 17,011), where this language is used by Mr. Justice Bradley: 'The next question is, whether the court will appoint a receiver. This is a matter always in the discretion of the court, but as a general rule a receiver will be appointed for the purpose of protecting the fund when the complainant has an equitable interest in the subject, and the defendant having possession of the property is wasting it, or removing it out of the jurisdiction of the court. But all the circumstances of the case are to be taken into consideration, and if the case be such that a greater injury would ensue from the appointment of a

receiver than from leaving the property in the hands now holding it, or if any other considerations of propriety or convenience render the appointment of a receiver improper or inexpedient, none will be appointed'."

After stating these general principles which govern the courts in the appointment of receivers, the court outlines the contentions of the minority bondholders. These contentions would seem at first blush to be reasonable and tenable. After stating them the opinion continues :

"Upon the other hand, we find the vast majority of the bondholders, under all the mortgages, insisting that the funding scheme is the best arrangement for all concerned, and that under that arrangement, faithfully and honestly carried out, the rights of all parties will be best secured. The company invites complainant and those now standing with him to join in that scheme with the large majority of those who have the same character of rights with them. That that scheme is being honestly adhered to, and will be carried out in good faith, the evidence does not permit me to doubt. I will not stop to state in detail all the reasons arising out of the evidence for the conclusions I have reached. * * * * * * * * * *

"If the present management of the road were guilty of any fraud or dishonest practices in their control of this property, I should feel differently. While there are differences between them and some of the bondholders, as to certain matters connected with the discharge of the company's obligations, those differences do not involve the integrity of those operating the railroad. The court is disposed to recognize the absolute necessity of large discretion in the man-

agement of such vast property, and in the distribution of the net income arising therefrom, and it is unwilling, for the present at least, to make honest differences as to such matters, the basis for its interference by the appointment of a receiver."

If the court will apply the principles announced in the foregoing decision to the facts in the case at bar, we think the conclusion will be irresistible that the decree appealed from should be affirmed. The scheme approved by the lower court offers an opportunity to the mortgagor to save what the mortgagor regards as a large equity. It offers the only reasonable chance of paying the second and third mortgages. The scheme has been consented to by the first and second mortgagees and by a majority, both in number and amount, of the beneficiaries under the third mortgage.

In view of the doctrine of the two cases last cited, and in view of the large discretion accorded by the law to the court of original jurisdiction, we submit that it would be a harsh rule to set aside this receivership and require a sacrifice sale of the mortgage security.

APPELLANTS' BRIEFS.

We have read appellants' briefs with much interest. The learned counsel for appellants have ably and forcefully presented all that can be said on their side of this controversy, but they have shown no ground for reversing the discretionary action of the lower court.

Appellants cite International Trust Company vs. Decker, 152 Fed. 78; Dalliba vs. Winschell, 11 Idaho 364, 371; First National Bank vs. Cook, 2 L. R. A. (N. S.) 1025; Wiggins vs. Neversink Company, 93 N. Y. Supp. 853; Hanna vs. State Trust Company, 70 Fed. 2, 8. Appellees have no quarrel with the rule announced in the foregoing authorities. The doctrine as stated by Judge Wolverton in the first of the foregoing cases is undoubtedly the law. The expenses of a receivership created at the instance of general creditors will not be permitted to displace mortgage liens except in the case of public service corporations, whose continued operation is a public necessity. We fail to see the relevancy of this principle to the case at bar. The contract authorized by the lower court assures to the receiver three dollars per thousand feet for all logs cut on the mortgaged premises. So long as the Humptulips Logging Company carries out its contract the operations will insure to the receiver the foregoing sum of money, over and above all expenses. It is probable that the operations will yield a larger sum of money. Whatever is realized will be devoted to the payment of the mortgage indebtedness in the order of its priority. As has been repeatedly pointed out by us, three dollars per thousand feet is the full market value of the stumpage.

It appears affirmatively that the Humptulips Logging Company is in sound financial condition and able to carry out the obligations assumed by it in its contract. Patterson affidavit, Record 274. The al-

legations of this affidavit are not controverted by appellants and are therefore established as a part of the record on this appeal. How, then, can the operations authorized by the lower court result in the creation of receivership expenses to the prejudice of the mortgagees? This is nowhere pointed out in appellants' briefs. If such result were possible it would still be competent for the lower court to direct the receiver to rescind the contract on sixty days' notice to the Humptulips Logging Company. It would be the disposition of the receiver and the mortgage creditors at whose instance he was appointed so to rescind if at any time it appeared that the operations were wasteful or disadvantageous to the estate.

The foregoing discussion of the facts of this case suffices to distinguish it from Farmers' Company vs. Grape Creek Company, 50 Fed. 481. The whole care of the court in that case was to avoid the creation of liens which would take precedence over mortgages. The question in that case was not whether a receiver should be appointed, but whether a receiver already appointed should be authorized to operate certain mines. Such operation involved risk of loss and the court refused to authorize it.

> Gutterson vs. Lebanon Company, 151 Fed. 72, 74.

The suit in this case was brought by general creditors, for the purpose of conserving assets and liquidating an insolvent corporation. A receiver was

appointed and his operation of the property proved unprofitable. The case before the court had to do with these receivership obligations. The receiver's mismanagement was proved and he was personally charged with a part of the indebtedness.

The argument of appellants on this branch of the case is predicated on their contention that the operation of the property authorized by the lower court will prejudice their equity of redemption. But how? What is the equity of redemption of a third mortgagee? How can he be prejudiced by any disposition of the security which assures that its full market value will be applied on the reduction of lien indebtedness admittedly prior?

United States vs. Masich, 44 Fed. 10.

The right of the third mortgagees in the case at bar is to redeem from the first and second mortgages and to be subrogated through such redemption to the rights of the first and second mortgagees.

If it be said that such redemption would require appellants to raise a large sum of money, we answer that they will be required to raise this same amount of money in order to protect their lien if the receivership is abrogated and the property sold without delay at master's sale, pursuant to their contention.

If the logging operations now in progress were to result in denuding the property of its timber without reducing the mortgage indebtedness, we can see how appellants would be injured by the order ap-

pealed from, and if such could be the result of these operations no one would object more strenuously that the first and second mortgagees and the creditors secured under the third mortgage who are in accord with the receivership program. But it is established by overwhelming testimony that three dollars per thousand feet is the full market value of the timber, and the contract authorized by the lower court assures the payment to the mortgagees of three dollars per thousand feet on all logs cut on the mortgaged property.

We think it unnecessary to notice all of the authorities cited in appellants' briefs. They are all cases in which the mortgagor resisted the receivership. In our case the mortgagor asks the receivership.

> Eureka Company vs. Lewiston Company, 12 Idaho 472.

This case, cited by appellants, was a suit to foreclose a chattel mortgage on a steamboat. The receivership was asked of the Supreme Court pending an appeal. The court held that the failure of the mortgagor to keep the boat insured did not constitute waste per se. This circumstance was nevertheless held to be important as bearing on the right to a receivership, and the court approved the case of Winkler vs. Madgburg, 76 N. W. 332, where under a different state of facts such failure to maintain insurance was held to constitute waste.

> Little Warrior Company vs. Hooper, 17 Southern 118, 119.

In this case a receiver had been appointed without notice at the instance of a stockholder and creditor. The case was one of disagreement in the internal management of a corporation. There was no allegation of insolvency. The receivership order was reversed; the corporation strenuously resisted the receivership.

Etowah Company vs. Wills Valley Company, 17 Southern 522.

In this case a receivership was sought by creditors and the debtor corporation resisted the application. The allegations on which the receiver was appointed in the lower court were not sustained by the evidence and the receivership order was reversed.

Ferguson vs. Dickinson, 138 S. W. 221.

In this case a creditor protected by a vendor's lien and also by a chattel mortgage claimed a receivership; the mortgagor resisted the application and offered to keep the property insured in such sum as the court should order. Under the Texas law the mortgagor is entitled to possession of the mortgaged property until the sheriff's deed issues. It was held that under the facts appearing in that case there was no justification for depriving the mortgagor of the possession of the property.

The remaining cases cited by appellants have been noted in the earlier part of this brief or are so clearly distinguishable from the case at bar that they call for no comment on our part. In view of

all of the circumstances which we have emphasized, we contend that the court would grievously err if it disturbed the order appealed from and required the property of the mortgagor appellee to be sacrificed at foreclosure sale.

Respectfully submitted,

SNOW, McCAMANT & BRONAUGH,

Northwestern Bank Bldg.,

Portland, Ore.

BRIDGES & BRUENER,

Aberdeen, Wash.

Attorneys for Appellees.